

*United States Court of Appeals
for the Second Circuit*



**BRIEF FOR
APPELLANT**

76-6070 76-6080

Signed

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

JOSEPH C. WEBER, INC.,

Plaintiff-Appellee-Cross-Appellant

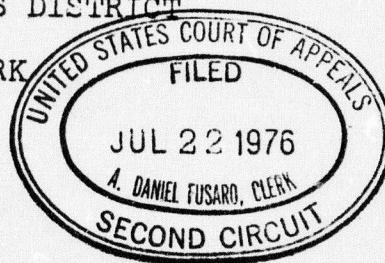
v.

UNITED STATES OF AMERICA,

Defendant-Appellant-Cross-Appellee

ON APPEALS FROM THE JUDGMENT OF THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF NEW YORK

BRIEF FOR THE UNITED STATES



SCOTT P. CRAMPTON,
Assistant Attorney General,

GILBERT E. ANDREWS,
WILLIAM A. FRIEDLANDER,
MICHAEL J. ROACH,
Attorneys,
Tax Division,
Department of Justice,
Washington, D. C. 20530.

Of Counsel:

RICHARD J. ARCARA,
United States Attorney.

TABLE OF CONTENTS

| | Page |
|---|------|
| Statement of the issue presented ----- | 1 |
| Statement of the case ----- | 1 |
| Summary of argument ----- | 6 |
| Argument: | |
| Since there was no evidence to support it, the District Court erred in refusing to set aside the verdict of the jury that the payments from Mobil to Weber were intended by the taxpayer as compensation for Weber's services ----- | 10 |
| Conclusion ----- | 22 |

CITATIONS

Cases:

| | |
|--|----------|
| <u>Larchfield Corp. v. United States</u> , 373 F. 2d 159 (C.A. 2, 1956) ----- | 11 |
| <u>Paula Construction Co. v. Commissioner</u> , 58 T.C. 1055 (1972) ----- | 11,19,20 |
| <u>X-L Service, Inc. v. Commissioner</u> , 32 T.C.M. 701 (1973) ----- | 11,19 |
| <u>Zeeman v. United States</u> , 395 F. 2d 861 (C.A. 2, 1958) ----- | 11 |

Miscellaneous:

| | |
|---|----|
| <u>8A Mertens Law of Federal Income Taxation</u> (Rev.), § 47A.25 p. 211 ----- | 11 |
|---|----|

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 76-6070 and 76-6080

JOSEPH C. WEBER, INC.,

Plaintiff-Appellee-Cross-Appellant

v.

UNITED STATES OF AMERICA,

Defendant-Appellant-Cross-Appellee

ON APPEALS FROM THE JUDGMENT OF THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF NEW YORK

BRIEF FOR THE UNITED STATES

STATEMENT OF THE ISSUE PRESENTED

Whether the District Court erred in denying the Government's motion for a judgment notwithstanding the verdict, in that the record was devoid of evidence capable of supporting the conclusion of the jury that payments made from Mobil Oil Corporation to Joseph C. Weber, the sole shareholder of taxpayer, Joseph C. Weber, Inc., were intended by the taxpayer as compensation to Weber for his services, rather than as dividends.

STATEMENT OF THE CASE

This is an appeal by the Government from the judgment of the United States District Court for the Western District of New York (Judge Curtin), entered on a jury verdict, and from the denial

of a timely motion by the Government for judgment notwithstanding the verdict. (R. 2-3.)^{1/} The District Court entered judgment in favor of the taxpayer, Joseph C. Weber, Inc., in the amount of \$82,154.13, plus interest, representing a refund of corporate income taxes for the taxable years 1963, 1964, and 1965, found to have been erroneously assessed and collected. (R. 4, 267.) The Government's motion for judgment notwithstanding the verdict was denied on February 19, 1976. (R. 271.) The charge to the jury by the District Court and the return of the verdict are reported at 76-1 U.S.T.C. par. 9253 (Nov. 5, 1975). The Government filed a timely notice of appeal on April 19, 1976, and the taxpayer filed a timely notice of appeal with respect to its cross appeal on April 23, 1976. (R. 3.) The jurisdiction of this Court is invoked pursuant to 28 U.S.C., Section 1291.

The facts as found by the District Court and as shown by the record are as follows:

The taxpayer, Joseph C. Weber, Inc., was incorporated in the State of New York on August 25, 1949 (Deft. Ex. 7), and, during the taxable years in issue, was engaged in the business of selling fuel oil in the Niagara Falls, New York, area (R. 25, 242-253). During the taxable years 1963 through 1965, the years involved in this litigation, the taxpayer's supplier of the heating oil and other petroleum products which it sold was Mobil Oil Company. (R. 26, 242-253.) From time to time, Mobil agreed to pay a special allowance based on the number of gallons of certain products,

I/ "R." references are to the separately bound record appendix.

particularly heating oil and kerosene, which the taxpayer purchased from Mobil. (R. 94-95, 100-101, 248, 254-263.) This special allowance was made by Mobil to meet offers made by competing suppliers to furnish the taxpayer with the petroleum products it needed at prices lower than the prices being charged by Mobil. (R. 94-95, 138-139, 248.) When a Mobil distributor, such as the taxpayer, received an offer from a competing supplier, Mobil's representatives would endeavor to substantiate that offer, and, if it was found to be in good faith, Mobil would attempt to meet it through a special allowance to the distributor. (R. 138-139.) In the present case, the amount of any such allowances authorized by Mobil was calculated monthly based on the gallonage purchased by the taxpayer in that month, and a credit invoice was prepared to authorize the issuance of a check in the appropriate amount. (R. 124-129, 138-139, 248, 254-263.)^{2/}

2/ These allowances were also referred to as competitive allowances (R. 139) or as temporary allowances (R. 144-145). The amount of the allowance was subject to review from time to time as the competitive situation changed (R. 144-145), and the amounts paid on taxpayer's purchases of fuel oil and kerosene varied from time to time during the years in issue (R. 254-263).

Under the agreements between Mobil and the taxpayer, as in effect during the taxable years in issue, the taxpayer was also entitled to receive a commission on certain large accounts obtained by it for Mobil, under which deliveries of fuel oil were to be made in tank car or tank wagon lots. (R. 244, 251.) On tank car deliveries the commission rate was to be \$.0025 per gallon. (R. 244, 251.) Payments of these commissions are also reflected in the credit invoices payable to taxpayer's account. (R. 254, 258-260, 262-263.)

At the request of Joseph C. Weber, the president and principal stockholder of the taxpayer, the payments of these special allowances arising out of taxpayer's purchases of kerosene and heating oil were made by check issued to Weber individually. (R. 25, 97, 101.) These payments were included in Weber's gross income for each of the years in suit. (R. 26.) The taxpayer, however, did not report any part of these allowances on its corporate income tax returns. (R. 26.) The Commissioner included these payments in the gross income of the taxpayer and assessed deficiencies accordingly for each of the years in suit. (R. 5-7.) The taxpayer filed timely claims for refund, and, more than six months later, brought this suit for refund. (R. 25.)

The Government contended that these special allowances arose out of the business of the taxpayer and that the amount of such special allowances was includable in the gross income of the taxpayer. (R. 51-52.) The Government further contended that the payment of such corporate income directly to Weber at his direction represented a constructive dividend to Weber, rather than the payment of additional compensation, since, even if the total of these payments plus Weber's salary would have been reasonable compensation for Weber's services, the taxpayer did not intend these additional payments to Weber as compensation. (R. 58-59.) The taxpayer contended that these payments were commissions earned by Weber individually, and, in the alternative, if they were found to be includable in the taxpayer's gross income, the payment of

such amounts to Weber individually represented additional reasonable compensation to him and was, accordingly, deductible by the taxpayer. (R. 45-46, 49.)

At the close of all the evidence, after motions for directed verdicts by both parties had been denied (R. 156-158), the case was submitted to the jury on special verdicts. The questions put to the jury and their answers were as follows (R. 240-241, 264-265):

1. Were the monies paid by Mobil Oil Company to Mr. Joseph Weber during 1953, 1954 and 1955 earned by Joseph C. Weber, Inc. (Weber Oil Company), or by Joseph C. Weber, individually?

JOSEPH C. WEBER, INC. X
JOSEPH C. WEBER

2. If the answer to question "1" is Joseph C. Weber, Inc. (Weber Oil Company), then answer this question: Were the monies paid intended by Joseph C. Weber, Inc. to be compensation or dividends to Joseph C. Weber as an individual at the time these payments were received by Joseph C. Weber?

COMPENSATION X
DIVIDENDS

3. If the answer to question "2" is "COMPENSATION", then answer this question: Was the compensation reasonable?

YES X
NO

Judgment was entered on the verdict. (R. 2.) The Government's motion for judgment notwithstanding the verdict and the taxpayer's motion to set aside the finding of the jury on the first issue were both denied by the District Court (R. 3). The Government has appealed from the denial of its motion to set aside the verdict on

the grounds that there was no evidence to support the finding of the jury that the payments from Mobil were intended by the taxpayer as compensation for Weber's services, and the taxpayer has cross-appealed from the refusal of the District Court to set aside the finding of the jury that the payments were earned by the taxpayer.^{3/}

SUMMARY OF ARGUMENT

The taxpayer's primary contention at trial was that the payments from Mobil were earned by Weber, as an individual, and not by it and were thus not income to it. It contended in the alternative that, if the payments were income to it, Weber's receipt thereof should be treated as additional (unreported) compensation from it, thus entitling it to an additional deduction equal in amount to, and offsetting, the additional income. The jury, rejecting taxpayers primary contention, found that the payments from Mobil were earned by the taxpayer and thus were taxable income to it, but found for taxpayer on its alternative contention that the payments were compensation to Weber.

As the District Court correctly instructed the jury, it could find the payments to be compensation only if it found that they were intended by taxpayer to be paid to Weber as compensation

^{3/} In this brief the Government will present only the arguments relating to its appeal on the question of whether the payments were intended by the taxpayer as compensation, reserving the right to respond to taxpayer's contentions with respect to its cross appeal in a subsequent brief.

at the time they were received by him. There is no record evidence of such an intention and thus the District Court erred in denying the Government's motion for judgment notwithstanding the verdict.

It must be understood that at no time before, or during, the trial did taxpayer ever contend, or seek to prove, that it had had the necessary contemporaneous intent to pay compensation. Its alternative position was based on the apparent theory of law that the payments could, without regard to actual contemporaneous intentions, be retroactively classified as compensation from it to Weber on the strength of nothing more than a showing that this would not exceed the level of reasonable compensation. It should further be noted that taxpayer's election to seek to prove, as its primary factual contention, that the Mobil payments constituted income to Weber, received directly by him from Mobil, effectively barred it from also seeking to prove the requisite contemporaneous intent on its part to pay these amounts to Weber as compensation from it. Obviously, taxpayer could not contend, and seek to prove, at the same trial both that it did not earn the payments in question (and thus that it could have had neither the ability nor the intention to pay them to its president as compensation) and also that it did earn the payments and intended to compensate its president by paying such amounts to him. Accordingly, the taxpayer introduced no evidence whatsoever tending to show that taxpayer regarded these amounts as belonging to it or that it intended to pay them to Weber as compensation or as anything else.

After the return of the verdict, the trial court denied the Government's motion for judgment notwithstanding the verdict, citing the stipulation and the tax returns of the corporation and of Weber as evidence on which the jury could have relied in finding that the taxpayer possessed the necessary intent to pay compensation to Weber. Neither of these items of evidence provides even the slightest support for the jury's finding, and the tax returns actually contradict it. The payments in question were not reported as income or deducted as compensation on the taxpayer's corporate tax returns, nor were they reported as compensation on Weber's individual tax returns. The stipulation does not contain a single word which even refers to the taxpayer's intent at the time these payments were made. Moreover, the Government certainly did not intend to, and did not, stipulate, to the existence of an intent on the part of the taxpayer which would have undercut its trial position and compelled judgment for taxpayer.

Significantly, the taxpayer used the stipulation at trial to support its contention that the payments in question were earned by Weber individually as commissions from Mobil, but nowhere did taxpayer's counsel ever contend that the stipulation reflected any agreement between the parties that the taxpayer had the requisite timely intent to compensate Weber with these payments. Thus, not only is there nothing in the stipulation which the jury could reasonably have read as an agreement between the parties that the taxpayer intended these Mobil payments to be compensation to its president, but neither of the parties

ever suggested that such an agreement was intended, and the trial court erred in relying on the stipulation as support for the jury's verdict on this question.

The taxpayer's suggestion in its opposition to the Government's motion for judgment notwithstanding the verdict, that the requisite intent was shown by the fact that Weber was an employee of the taxpayer and that he directed the payments to be made to him personally is totally without substance. It rests on the assumed premise that the payments must have been intended as compensation because the corporation could have chosen to pay them in that character. But the taxpayer ignores the critical fact that, even assuming that it intended to make the payments to Weber at all, Weber was also the 99 percent shareholder of the taxpayer and was therefore equally entitled to receive the payments as dividends. With three possibilities open -- namely (1) that the taxpayer did not regard the amounts as belonging to it and thus had no intention to pay them to Weber for any purpose; (2) that it intended to pay them as dividends; and (3) that it intended to pay them as compensation -- the burden was on the taxpayer to show that the payments were actually intended to be paid as compensation, and it cannot meet this burden merely by pointing to evidence that additional compensation would not have been unreasonable. There are two independent grounds upon which the deduction for compensation could be disallowed -- (1) that the payments were not actually, and at the time, intended to be paid as compensation; and (2) that, even if so intended, the total amount paid was in excess of reasonable compensation. Proof of reasonableness does not constitute proof of intent.

Accordingly, the judgment of the District Court should be reversed with direction to enter judgment for the Government notwithstanding the verdict.

ARGUMENT

SINCE THERE WAS NO EVIDENCE TO SUPPORT IT, THE DISTRICT COURT ERRED IN REFUSING TO SET ASIDE THE VERDICT OF THE JURY THAT THE PAYMENTS FROM MOBIL TO WEBER WERE INTENDED BY THE TAXPAYER AS COMPENSATION FOR WEBER'S SERVICES

The jury verdict in this case consists of the answers to three questions. (R. 240-241.) The first question related to whether the taxpayer or Joseph C. Weber individually earned the payments made by Mobil Oil Company. (R. 240.) It was the contention of the Government that the payments were in consideration of the acts and agreements of the taxpayer Joseph C. Weber, Inc. (hereinafter the taxpayer) and that, under established principles, the payments, having been earned by taxpayer, belonged to it, and not Joseph C. Weber. By their answer, the jury found, as the Government contended, that the payments were earned by the corporate taxpayer and were income to it. (R. 177-178, 240.)

Having failed to persuade the jury that the special allowances paid by Mobil were earned by Weber individually (R. 240), the taxpayer sought the same tax result by offering the alternative theory that these same amounts also represented tax deductible

compensation paid by the taxpayer to Weber and that the payment of such compensation cancelled out its receipt of the income. As to this, the taxpayer was required to meet its burden of proof ^{4/} on every element of its claim. As the court below correctly instructed the jury (R. 232-233), the key fact which the taxpayer was required to establish was that the payments by the taxpayer were intended at the time they were made, ^{5/} as compensation to Weber for services and not as dividends. No corporate records were introduced and no testimony by Weber or any other officer of the taxpayer was offered to show such an intent with respect to these payments. In view of this lack of evidence, Government counsel moved the District Court (R. 156-157) to take from the jury's consideration the alternative question whether, at the time the payments were received by Weber, they were intended to constitute compensation from the taxpayer to him for his services, rather than dividends to which he was entitled in his capacity as shareholder. ^{6/} The motion was denied and the issue submitted to the jury. Understandably, counsel for taxpayer in his argument to the jury failed to mention a

^{4/} 8A Mertens Law of Federal Income Taxation (Rev.), § 47A.25, p. 211. Zeeman v. United States, 395 F. 2d 861, 865 (C.A. 2, 1968); Larchfield Corp. v. United States, 373 F. 2d 159, 165 (C.A. 2, 1966).

^{5/} See Paula Construction Co. v. Commissioner, 58 T.C. 1055, 1059-1060 (1972), and X-L Service, Inc. v. Commissioner, 32 T.C.M. 701, 705 (1973), holding that, to qualify as compensation, the critical intent is that which existed at the time the payment was made and not some self-serving hindsight classification.

^{6/} This question, of course, would only be reached in the event the jury concluded, as it did, that the payments were earned from Mobil by the taxpayer, rather than by Weber as an individual.

single item of evidence going to the point in question. His only comment with respect to this question (R. 212-213) was that nobody had ever asserted that the payments were dividends except a government lawyer twelve years after the event and that, therefore, the jury could not in good conscience find other than that the payments were compensation.^{7/} This, of course, is not evidence and represented only an effort to get the jury improperly, and in disregard of the court's instructions (R. 227), to place the burden of proof on the Government. It may be well here to point out the apparent reason why the taxpayer could not afford to introduce evidence in support of the factual contention that the payments were intended by it to be compensation to Weber. Taxpayer was on the horns of a factual dilemma. Its primary factual contention (the subject of taxpayer's cross-appeal in this Court) was that the payments were received by Weber from Mobil for his services as an individual and that they were not received from taxpayer at all and did not pass through taxpayer's hands. Unlike inconsistent legal constructions of a given factual situation which can be asserted in the alternative, a litigant cannot assert, and seek to prove, in the same trial both that it did and that it did not believe at a given time that it was making compensation payments to an employee. Therefore, taxpayer had to make its election as to which of these contentions as to its corporate state of mind it was going to

^{7/} Counsel, however, neglected to point out to the jury the equally true fact that no one (including particularly the taxpayer)-- see its tax returns (Deft. Exs. 1, 2, 3; R. 26) had ever suggested that the payments were compensation from taxpayer until the Internal Revenue Service took the position on audit that the payments were unreported income to taxpayer.

seek to prove at trial. Having made the almost obvious choice (in view of the manner in which the transaction was reported in the tax returns) to seek to prove that the payments had not belonged to the corporation, taxpayer could not possibly offer any testimony or other evidence which was actually probative of a corporate belief that the amounts belonged to it or that it was paying them to Weber as compensation, since this would give the lie to taxpayer's primary factual position and impugn the good faith of both it and Weber in their respective tax returns for the years in question.

Taxpayer attempted, however, against the possibility that the jury would not accept its primary factual position, to preserve as a fallback contention the argument that, if the amounts were earnings to the corporation they were also deductible compensation payments to Weber, by relying upon the apparent theory of law that compensation payments could be imputed retroactively on the basis of the mere fact that, if made, they would not have enlarged payments to the employee beyond the level of reasonable compensation (see taxpayer's claim for refund, R. 12-23). Since this legal approach did not require a showing of actual contemporaneous intent to pay compensation, it relieved taxpayer of the need to offer evidence of such intent which would conflict with its primary factual position. However, upon the strength of the Government's demonstration (see authorities cited in fn. 5, supra) that amounts may not be treated as compensation for tax purposes in the absence of proof that they were so intended at the time the payments were made, the District

Court so instructed the jury (R. 232-233). The Government then moved the court, as noted previously, to take the question as to compensation from the jury since taxpayer had not offered any evidence of the necessary intent. When this was denied, the jury got the question with correct instructions that it had to find intent to pay compensation at the time the payments were received by Weber^{8/} but, for the above reasons, without any record evidence of such intent having been presented by taxpayer.

Upon the return of the finding by the jury that the payments had been intended as compensation to Weber (R. 240) in spite of the absence of supporting evidence and in spite of the fact that taxpayer's factual posture at trial had been to the effect that it had not regarded the amounts in question as belonging to it and thus could have had no intent to pay them to Weber for any purpose, the Government moved for judgment notwithstanding the verdict. The District Court denied the motion (R. 270-271), citing as evidence upon which the jury could properly have relied the "stipulation between the parties" and the tax returns of the taxpayer corporation and of Weber. We submit that none of these has the slightest capacity to evidence the requisite intent. Taking first the tax returns, it is difficult to imagine what the court below could have had in mind since Weber's returns reflect the payments as having been made to him by Mobil in return for services purportedly rendered by him to Mobil. The corporate returns of taxpayer reflect that the payments were never received

^{8/} Note that the written question put to, and answered by, the Jury was whether the amounts were intended by the taxpayer to be compensation to Weber. (R. 240).

or earned by it and that they were thus unavailable for payment to Weber -- either as compensation or anything else -- and report the compensation paid to Weber as being limited to the amounts actually paid him as salary and exclusive of the amounts here in issue.

Thus, if given any weight as evidence, the returns refute, rather than support, the contention that the amounts in issue were intended to be paid by taxpayer as compensation to Weber.

With respect to the stipulation, it is rather difficult to analyze the court's reference thereto as evidence since the court did not specify what portion of the stipulation it had in mind nor did it explain how any part of the stipulation could support the conclusion that there was a contemporaneous intent of taxpayer to pay these amounts as compensation. We submit that there is not a single word in any paragraph of the stipulation which, strained to the utmost, could possibly be taken to be an agreement of fact that taxpayer had intended that the amounts paid to Weber by Mob 1 were recognized by taxpayer as income to it and were intended, at the time of the payments, to be compensation paid by it to Weber. Further, we state that the Government never had the slightest intention of stipulating to anything which could lead to the conclusion in question--a fact which would be self-evident since, in doing so, it would in effect have undercut the very tax consequence which it was seeking to enforce
in the litigation.
^{9/}

9/ We suggest that, if the District Court truly viewed the stipulation as being an agreement that the taxpayer had intended to pay compensation to Weber in the amounts in question, it should have decided the issue in favor of taxpayer as a matter of law, rather than submitting it to the jury.

It is important to note here that, counsel for taxpayer, in his argument to the jury with respect to this issue (R. 212-213) never suggested to the jury that the stipulation had any relevance with respect thereto. Indeed, he could scarcely have done so, having burned his bridges behind him by relying on the stipulation in his jury argument (R. 205-208) as support for his primary factual contention that, in fact and according to Weber's understanding, the payments belonged to Weber and not to the corporation. As indicated earlier, this factual contention is incompatible with a belief by the corporation ^{10/} that the amounts belonged to it and, therefore, with an intent by it to pay these amounts to Weber as compensation. A stipulation involves meeting of the minds of the stipulating parties as to certain agreed facts. Since taxpayer, as one of such parties, cannot possibly contend that it intended, in entering into the stipulation, to agree both that the payments did not belong to taxpayer and also that they did, in relying upon the stipulation as support for the first of the above incompatible factual propositions taxpayer necessarily disclaimed the stipulation as support for the latter contention. That this is so, is further demonstrated by the fact that, in its opposition to the

10/ Since Weber was the controlling officer of the corporation, any beliefs and intentions which it had on these subjects would necessarily be those of Weber.

Government's motion for judgment notwithstanding the verdict (Pltf. Memo. (Dec. 1, 1975), pp. 6-8), taxpayer did not suggest that the stipulation should or could be viewed as supporting the jury verdict on the compensation issue. Thus, we are left with a situation in which neither of the parties to the stipulation held it forth as reflecting an intended agreement with respect to whether the taxpayer had intended to pay compensation to Weber in the amount of the Mobil payments. This, coupled with the fact that it clearly does not purport to deal with that issue, demonstrates the error of the court below in relying upon it as evidence in support of the jury's finding on the second question.

As noted, in opposing the Government's motion for judgment, taxpayer did not cite the stipulation as evidence. It did, however, suggest that supporting evidence could be found in the facts (1) that Weber had instructed Mobil to deliver the payments to him personally at his residence and (2) that Weber was an employee of taxpayer and performed services for it. (Pltf. Memo. (Dec. 1, 1975), p. 7.) It did not, however, offer any suggestion as to how these facts could support an inference that the payments were actually intended to be received by Weber as compensation from taxpayer. We think it interesting that the District Court, in

denying the Government's motion, apparently did not think enough of these suggested items of evidence even to mention them. It was well justified in this. We fail to see the slightest connection between the fact that the payments were to be delivered to Weber and the question as to whether they were received by him as compensation or as dividends from taxpayer. Delivery to Weber could support only the inference that he regarded the payments as earned by and belonging to him, individually, rather than to the corporation and that he did not regard the payments as coming to him from the taxpayer corporation. This would be as inconsistent with the view that the amounts were paid to him by the corporation as compensation as with the view that they were paid to him by the corporation ^{11/} as dividends. Once it was determined by the jury that the payments belonged to the taxpayer and had to have been received by Weber from it, the only remaining question was whether they were to be treated as having been received as dividends, as compensation, or as something else, and the fact that Weber caused the payments to come directly to him from Mobil is totally irrelevant to that question.

11/ It is important to note that, while the payments can be classed as compensation only on a finding of actual intent to pay them to Weber as such, this is not true with respect to treating them as dividends. Any amounts received from a corporation by a shareholder which are not shown to have been received by him in some other capacity are deemed to have been received as a constructive dividend. Thus, if it appears (as is obviously the case here) that the corporation did not regard itself as paying the money to Weber at all, and thus could not have intended it to be compensation, rather than dividends, it must be treated as the latter.

The same is true with respect to the fact that Weber was an employee of, and performed services for, taxpayer. This shows no more than that there was the necessary relationship to justify a payment of compensation. But, Weber was also the shareholder of the corporation which was earning profits and, as such, Weber was entitled to receive the amounts in question as dividends. The Commissioner took the view that the payments had the character of dividends and taxpayer contended that they should be regarded as compensation. As noted previously, the governing law is that payments by a corporation may be treated as compensation only where it is shown that, at the time the payments were made, they were intended to be such. So recognizing, the court below correctly so instructed the jury (R. 232-233). It also correctly instructed the jury that the burden was on the taxpayer to prove all the factual elements necessary to establish a right to refund. (R. 227). Thus, taxpayer could not recover on the sole showing that, as an employee, the taxpayer could have chosen to make the payments to Weber as compensation. It was required to show that, in fact, that was its intent and that it did not intend the payments to be distributions of dividends. The fact that Weber was an employee does not have the capacity to show this in the face of the fact that Weber was also a shareholder.

The lack of probative character in the mere fact that the recipient was an employee who had performed services was explained in both Paula Construction Co. v. Commissioner, 58 T.C. 1055,

1059 (1972), aff'd, per curiam, 474 F. 2d 1345 (C.A. 5, 1973) and X-L Service, Inc. v. Commissioner, 32 T.C.M. 701 (1973). ^{12/}

The court below took the view in its order denying the Government's motion for judgment notwithstanding the verdict (R. 271) that these cases are not controlling precedents because they represent merely factual findings which differ from that of the jury in the instant case. This, of course, would be valid only if the court were correct in assuming that there was before the instant jury some evidence capable of supporting its finding. ^{13/} But the rationale of the cited cases is not that the evidence of noncompensation predominated over evidence tending to show that the payments were compensatory (i.e., the fact that the recipients were employees whose services were sufficient to justify additional compensation) but, rather, that the record was devoid of any evidence that compensation was in fact intended. Indeed, in Paula Construction Co., supra, p. 1059, the court, after having recognized that the recipient shareholders were also employees who had performed substantial and valuable services which would

^{12/} The facts and issues in X-L Services, Inc. are so identical to those here involved that it could be the same case.

^{13/} For the reasons pointed out earlier with respect to the taxpayer's dilemma in choosing between the two incompatible factual positions, if any of the items mentioned by taxpayer or by the court below were actually probative of a belief on the part of Weber that the payments came to him from the taxpayer as compensation, taxpayer would scarcely have introduced it and thus refuted its own primary contention.

14 /

have entitled them to additional compensation,^{14 /} said that the taxpayer had "utterly failed to produce any evidence showing that the distributions were made with the intent of compensating [the individuals in question]." Thus, the result reached in the instant case is squarely in conflict with that reached in the two cited cases and cannot be reconciled on the basis on the latitude allowed to the trier of fact. The Government here concedes that, if the mere fact that Weber's employee status and rendition of services constituted evidence sufficient to take the case to the jury in the face of the fact that he was also a shareholder entitled to receive the amounts in question as dividends, there is no basis for reversing the judgment based on the jury finding. It is the very essence of our position that this fact is not evidence that compensation was intended (which was apparently recognized by the court below) and that the two cited cases constitute clear authority to that effect--amply reinforced by the analysis set out hereinabove.

14 / The two individuals involved in Paula Construction Co., although they had performed valuable services as corporate officers and employees, had (p. 1057) received no salaries in the years in question. The amounts to which each would fairly have been entitled as compensation were also stipulated (p. 1057). Yet the court held that the amounts were taxable as dividends because there was no evidence that the amounts had been intended to be paid as compensation.

CONCLUSION

For the reasons stated, the judgment of the District Court should be reversed with directions to the District Court to enter judgment for the United States notwithstanding the verdict.

Respectfully submitted,

SCOTT P. CRAMPTON
Assistant Attorney General,

GILBERT E. ANDREWS,
WILLIAM A. FRIEDLANDER,
MICHAEL J. ROACH,
Attorneys,
Tax Division,
Department of Justice,
Washington, D. C. 20530.

Of Counsel:

RICHARD J. ARCARA,
United States Attorney.

JULY, 1976.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 20th day of July, 1976, in an envelope, with postage prepaid, properly addressed to him as follows:

Ralph L. Halpern, Esquire
10 Lafayette Square
Buffalo, New York 14203

Gilbert E. Andrews/enc
GILBERT E. ANDREWS,
Attorney.